Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

LEONARD GREENE and JOYCE GREENE,

Petitioners,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether this 1996 decision by the Second Circuit or conflicting decisions by the Ninth Circuit (1995) and the D.C. Circuit (1992) correctly state the rule for issue preclusion (collateral estoppel) in this tax case, and accord with this Court's decision in *Montana v. United States*, 440 U.S. 147 (1979).

2. Whether a prior Second Circuit decision, that capital gain need not be recognized by these taxpayers for certain 1982 charitable donations of appreciated commodity futures contracts, is entitled to issue preclusive effect in a later case between the Government and these same taxpayers, or may be overturned for identical 1983-87 transactions, under identical controlling law, on the basis of a new argument that the Government had available for the 1982 case but failed to raise adequately.

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Petitioners Leonard and Joyce Greene respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 2, 1996 in the above-entitled proceeding. Rehearing was denied on June 4, 1996.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit is reported at 79 F.3d 1348, and is reprinted in the appendix at 3a. The District Court decision is reported at 864 F. Supp. 407 and is reprinted in the appendix at 25a.

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statutes involved in the case are in the Internal Revenue Code, specifically 26 U.S.C. §§ 170, 1001, 1256. The full text of relevant provisions is set forth in the appendix at 47a.

STATEMENT OF THE CASE

The tax issues involved in this case ("*Greene II*") were fully and fairly litigated in a prior tax refund action involving the petitioners' 1982 tax return. *Greene v. United States*, 806 F. Supp. 1165 (S.D.N.Y. 1992), *aff'd*, 13 F.3d 577 (2d Cir. 1994) ("*Greene I*"). The question meriting review by this Court is whether, under the standard set out in *Montana v. United States*, 440 U.S. 147, 99 S. Ct. 970, 59 L. Ed. 2d 210 (1979) and in accordance with two recent decisions by the Ninth and D.C. Circuits, both of which conflict with the

Second Circuit's holding here, the issue preclusive effect of the prior judgment precludes the Government from raising a new argument in a subsequent tax refund case for 1983-87, against the same taxpayers, on identical facts and under the same controlling law.

Here the Government was permitted to assert a new argument of law and the *Greene II* court applied it to reach a different determination of the same "right, question or fact," *Montana, supra*, 440 U.S. at 153, quoting *Southern Pacific R. Co. v. United States*, 168 U.S. 1, 48-49, 18 S. Ct. 18, 27, 42 L. Ed. 355 (1897), that had been resolved by the prior litigation. Both the Ninth Circuit (in a tax case) and the D.C. Circuit have recently held to the contrary, *i.e.*, that there is issue preclusion, or collateral estoppel, in such circumstances. *Kamilche Co. v. United States*, 53 F.3d 1059, 1063 (9th Cir. 1995), *modified*, 75 F.3d 1391 (9th Cir. 1996); *Yamaha Corp. of America v. United States*, 961 F.2d 245, 254 (D.C. Cir. 1992), *cert. denied*, __ U.S. __, 113 S. Ct. 1044 (1993). They thus are in conflict with the Second Circuit.

It has been settled law that issue preclusion applies for tax cases involving different tax years. *Commissioner of Internal Revenue v. Sunnen*, 333 U.S. 591, 599-600, 68 S. Ct. 715, 720 (1948); *Montana, supra*. It is only claim preclusion, or *res judicata*, which has been held inapplicable, on the theory that each tax year gives rise to a separate claim. *Sunnen, supra*.

The tax question both in the prior litigation (*Greene I*) and this case (*Greene II*) was whether or not the taxpayers had to recognize capital gain when giving appreciated commodity futures contracts to a charity. *Greene I* held they did not, in line with similar treatment for charitable donations of other appreciated property. In *Greene II* the Government addressed a new argument to this issue, which had been available to it for

Greene I but which it had inadequately raised. *See Greene I*, 13 F.3d at 585-86. The facts were identical and controlling law had not changed. Nevertheless, the Second Circuit overruled the taxpayers on the question of issue preclusion and reached a result opposite to that of the prior panel, ruling that capital gain did have to be recognized for the identical transactions in later years.

Such charitable donations had been a longstanding practice of petitioners Leonard and Joyce Greene. Starting in 1974, the petitioners had made such donations in reliance on a letter ruling issued to Mr. Greene by the Internal Revenue Service ("IRS") in 1974. In almost every subsequent year they claimed a charitable deduction for the market value of the donated contracts, and did not recognize or pay taxes on the unrealized gain inherent in the donated contracts.[1] Until the audit for their 1982 year, in 1989, the IRS never challenged them for not recognizing capital gains, and they gave charities millions in appreciated commodity futures contracts. After that, the IRS challenged 1982 and all subsequent years, so that the total amount of tax, interest and penalties eventually in dispute exceeded four million dollars.

The controversy arose as a result of 1981 amendments to the Internal Revenue Code ("IRC"), enacted with respect to futures contracts. In particular, IRC § 1256 was enacted "to

---

1. This treatment was consistent with the longstanding rule of §170 of the Code, which, in order to encourage charitable donations, provides that no taxable gain is recognized by the donor when the entire interest in appreciated long-term capital gain property is transferred to a qualified charity. *Grove v. Commissioner*, 490 F.2d 241, 246 (2d Cir. 1973); *see also Greene I*, 13 F.3d at 580-81; *Sheppard v. United States*, 361 F.2d 972, 979 (Ct. Cl. 1966); 26 U.S.C. §§ 170(b)(1)(C)(i), 170(b)(1)(F) (1988); *S.C. Johnson & Son, Inc. v. Commissioner*, 63 T.C. 778 (1975).

combat perceived tax abuses by commodities traders," (*Greene I*, 13 F.3d at 579), essentially involving straddles. The practice of using commodities straddles to convert short-term gain into long-term gain was ended by arbitrarily classifying all gains as 60% long-term and 40% short-term. 26 U.S.C. § 1256(a)(3). The practice of using them to defer income was ended by requiring that commodities futures be marked to market at year-end or in certain terminations. 26 U.S.C. § 1256(a) and (c).

The Greenes' commodities contracts were not straddles. As the District Judge found — and the Government has never made a claim to the contrary — "the record contains absolutely no evidence of any abuse by plaintiffs (taxpayers)." (*Greene I*, 806 F. Supp at 1169). The taxpayers' problems with IRS arose from their efforts to adapt their charitable giving to the new technical rules of the 1981 amendments, while continuing substantively as they had before under their 1974 letter ruling. To do this they gave the charity only the 60% long-term portion of the futures contracts' appreciation, since the charitable contribution section of the Code, 26 U.S.C. § 170, only permits charitable deductions for long-term gains. They paid tax on the 40% short-term gains. Otherwise they continued as before.

In both *Greene I* and *Greene II*, the Government attacked the taxpayers' post-1981 transactions and sought to require recognition of long-term gain at the time of donation.[2] In *Greene I*, it invoked the tax theories of assignment of income and step transaction, to require recognition of long-term gain for 1982. Both the District Court and Circuit Court rejected that attack and held that no gain need be recognized, even

---

2. In *Greene II*, the Government also attacked the charitable deductions on still another legal theory in the District Court, but abandoned the point on appeal.

though only the 60% long-term portions of the contracts had been donated.

In *Greene I*, the Government also raised on appeal the applicability of IRC § 1256(c), to argue that any charitable gift of appreciated commodity futures contracts required the donors to recognize capital gain when made, even though the taxpayers never realized any money or property from the transaction. The Second Circuit in *Greene I* declined to hear the point because it had not been raised in the District Court and had been inadequately briefed and argued in the Circuit Court. *Greene I*, 13 F.3d at 585-6.

In *Greene II*, when the same issue arose for tax years 1983-1987, the District Court held that the Government's new IRC § 1256(c) legal theory could be raised. In so holding, it defined as issues adjudicated in the prior case only those legal arguments that had been raised then, rather than holding that the issue of capital gain recognition had been determined and was entitled to issue preclusive effect. It thereupon denied issue preclusion and reached the merits, holding for the taxpayers. The Second Circuit, in conflict with the Ninth Circuit and the D.C. Circuit, and at odds with this Court's *Montana* decision, affirmed the District Court's issue preclusion holding, reversed on the merits, and remanded with a direction that capital gains be recognized for the identical 1983-87 transactions.

REASONS FOR GRANTING THE WRIT

I.

ISSUE PRECLUSION IS FREQUENTLY OF PRESSING IMPORTANCE IN TAX LITIGATION AND GENERALLY; THE CONFLICT BETWEEN THE CIRCUITS SHOULD BE SPEEDILY RESOLVED.

It has long been held that issue preclusion, or collateral estoppel, applies in tax cases as it applies generally, *i.e.*, when "the issues presented by [the second] litigation are in substance the same as those resolved [in the first]." *Montana*, 440 U.S. at 155, 99 S. Ct. at 974. This Court has defined an "issue" as a "*fact, question* or *right* distinctly adjudged in the original action." *United States v. Moser*, 266 U.S. 236, 242, 45 S. Ct. 66, 67, 69 L. Ed. 262 (1924), quoted in *Montana*, 440 U.S. at 162, 99 S. Ct. at 978 (1979). Once decided, it "cannot be disputed in a subsequent action, even though the determination was reached upon an erroneous view or by an erroneous application of the law." *Moser, supra*. In contrast, traditional law holds that claim preclusion, or *res judicata*, is not available for disputes occurring in different tax years. *Sunnen*, 333 U.S. at 597-98.

The central question of much issue preclusion litigation is presented by this case, *i.e.*, is the "issue" before the second court "in substance the same" as one determined in the prior litigation. To aid in analysis of that question, both the Second and Ninth Circuits, in their conflicting decisions, turned for guidance to the Restatement (Second) of Judgments § 27 (1982), which reads in pertinent part as follows:

> Is there a substantial overlap between the evidence or argument to be advanced in the

> second proceeding and that advanced in the first? Does the new evidence or argument involve application of the same rule of law as that involved in the prior proceeding? Could pretrial preparation and discovery relating to the matter presented in the first action reasonably be expected to have embraced the matter sought to be presented in the second? How closely related are the claims involved in the two proceedings?

Restatement (Second) of Judgments § 27, comment c.

The Second Circuit in *Greene II*, referring explicitly to the Restatement tests, held that the Government's new legal argument was an "issue" that had not been actually decided in *Greene I*. It reasoned that, even though the evidence involved was "essentially the same, the government's new argument involves application of entirely different rules than those involved in the initial litigation." *Greene II*, 79 F.3d at 1353.

In square conflict with this Second Circuit holding, the Ninth Circuit and the D.C. Circuit have recently rejected efforts to raise a new legal argument as a basis for upsetting a prior determination, when the new legal argument was not based on a change in the legal principles involved. *Kamilche*, *supra*, the Ninth Circuit case, involved two lawsuits between the United States and Kamilche's subsidiary, Simpson. In the first, a condemnation proceeding, a final judgment determined that Simpson owned a strip of land, so that it could not be taken without payment. In a separate dispute with the State of California, Simpson settled by agreeing to donate that same land to the State. Simpson then took a federal income tax charitable deduction of $14,100,000, the value of the land. The Internal Revenue Service disallowed the deduction, the

taxpayer paid, and like these taxpayers, filed a refund suit. In that refund suit, the Government raised a new legal theory which had been available to it in the first lawsuit but which it had not raised. The new theory was that the State already owned the land through adverse possession, so that the taxpayer had nothing and could not take a charitable deduction. *Id.*, 53 F.3d at 1060-61. This situation is an exact parallel to the instant case, where the Government did not adequately raise its new legal theory in *Greene I* but then asserted it in *Greene II*.

The Ninth Circuit, reversing the District Court, held that the judgment in the earlier case collaterally estopped the Government from raising its new legal theory in the second case, the tax refund case. The Court's language in *Kamilche* makes its conflict with the Second Circuit crystal clear:

> The United States argues that because the issue of adverse possession was never raised in *Simpson I* [the earlier case], that decision cannot collaterally estop the United States from litigating such issue in the instant proceeding.
>
> The United States fails to recognize that "once an *issue* is raised and determined, it is the entire *issue* that is precluded, not just the particular arguments raised in support of it in the first case." *Yamaha Corp. of America v. United States*, 961 F.2d 245, 254 (D.C. Cir. 1992), *cert. denied*, __ U.S. __, 113 S. Ct. 1044, 122 L. Ed. 2d 353 (1993). *See also* Restatement (Second) of Judgments § 27 ("[I]f the party against whom preclusion is sought did in fact litigate an issue . . . and suffered an adverse

> determination, . . . new arguments may not be presented to obtain a different determination of that issue."); 1B Moore's Federal Practice ¶0.443[2] ("Any contention that is necessarily inconsistent with a prior adjudication of a material and litigated issue . . . is subsumed in that issue and precluded by the effect of the prior judgment as collateral estoppel.").
>
> The United States cannot now argue adverse possession--or any other legal theory--that is inconsistent with the *Simpson I* court's ruling that Simpson owns the disputed property. Any such challenges are subsumed in and precluded by *Simpson I's* collateral estoppel effect.
>
> * * *
>
> Because it has been judicially determined that Simpson owned the lands at issue, Simpson properly took a charitable deduction on its corporate income tax return for the contribution of these lands and thus is entitled to a refund.

Kamilche, 53 F.3d at 1063 (footnotes omitted).

Under this decision, a holding in one case that capital gain did not have to be recognized would have preclusively controlled the issue in subsequent litigation, so that, for an identical transaction under identical controlling law, capital gain would also not have to be recognized. Thus this decision is squarely in conflict with the Second Circuit decision in *Greene II*.

Indeed, the quoted language also shows how differently the Ninth Circuit read the Restatement (Second) of Judgments § 27, comment c. The Second Circuit took that comment to mean that a new legal argument could be raised, while the Ninth Circuit cited a different part of comment c to reach the opposite result.

The D.C. Circuit is also in conflict with the Second Circuit on this question. In the case cited by the Ninth Circuit, *Yamaha*, *supra*, a prior judgment had dismissed certain claims. When Yamaha-America tried a new approach in later litigation, the District Court would not consider it because of issue preclusion. As the D.C. Circuit pointed out, in describing the District Court's decision:

> The fact that the district court might have reached a different conclusion on the merits under the law of this Circuit is irrelevant, for the doctrine of issue preclusion prevents reaching the merits, even where a different view would prevail.

Yamaha, 961 F.2d at 253.

The D.C. Circuit's analysis, in its decision affirming the availability of issue preclusion to preclude new arguments, shows that it is also in sharp conflict with the Second Circuit's *Greene II* decision. It, like the Ninth Circuit, drew exactly the opposite conclusion from the Restatement (Second) of Judgments § 27, comment c. The court held:

> In issue preclusion, it is the prior *judgment* that matters, not the court's opinion explicating the judgment. "Even in the absence of *any* opinion a judgment bars relitigation of an issue necessary to the

> judgment." *American Iron & Steel Inst. v. EPA*, 886 F.2d 390, 397 (D.C. Cir. 1989) (emphasis in original), *cert. denied*, __ U.S. __, 110 S. Ct. 3237, 111 L. Ed. 2d 748 (1990). Furthermore, once an *issue* is raised and determined, it is the entire *issue* that is precluded, not just the particular arguments raised in support of it in the first case. *See Securities Indus. Ass'n v. Board of Governors*, 900 F.2d 360, 364 (D.C. Cir. 1990) (plaintiff may not raise new argument in second proceeding even though it was never made in the first proceeding; so long as argument could have been made, it is precluded); RESTATEMENT (SECOND) OF JUDGMENTS § 27 cmt. c at 253 (if previously litigated "issue was one of law, new arguments may not be presented to obtain a different determination of that issue").

961 F.2d at 254.[3]

---

3. *See also Sydnes v. C.I.R.*, 647 F.2d 813, 815 (8th Cir. 1981) (suit seeking redetermination of identical question of tax statute's application, based on assertion that court's opinion in prior suit contains untrue statements, is barred); *Gillespie v. C.I.R.*, 151 F.2d 903 (10th Cir. 1945), *cert. denied*, 328 U.S. 880, 66 S. Ct. 1363, 90 L. Ed. 1648 (1946) (taxpayer barred from relitigating the tax consequences of a transaction by raising a new argument, even though his wife, suing on that different theory, had succeeded in her suit concerning payments arising out of the same transaction); *Jones v. United States*, 466 F.2d 131, 136 (10th Cir. 1972), *cert. denied*, 409 U.S. 1125, 93 S. Ct. 938 (1973) (taxpayers were not entitled to relitigate issues for later tax years "with benefit of hindsight"; new evidence available at time of first trial would not be admitted).

In resolving this conflict, finally, this Court will have occasion to clarify its own decisions in this area. The Ninth Circuit took the position that this Court's *Montana* decision does not permit new legal arguments in the face of a prior issue determination except where there has been a "significant change in the legal climate," citing its prior construction of *Montana* in *Starker v. United States*, 602 F.2d 1341, 1344 (9th Cir. 1979). In so doing, it held that a more permissive approach to new argument could not be drawn from this Court's earlier decision in *Sunnen*. As the Ninth Circuit put it:

> *Sunnen's* scope has been substantially narrowed by the Supreme Court, however. *See Montana v. United States*, 440 U.S. 147, 161, 99 S. Ct. 970, 977-78, 59 L. Ed. 2d 210 (1979); *Starker*, 602 F.2d at 1346-47. *Sunnen* was limited by the Court to cases in which there had been a "significant change in the legal climate." *Starker*, 602 F.2d at 1347. . . . As there [had] been no such change in the instant case, *Sunnen's* narrow standard does not govern.

Kamilche, 53 F.3d at 1062-3, fn 3. Those same words apply here, in square conflict with the Second Circuit's decision.

Thus we have the Second Circuit in conflict with the Ninth Circuit in a tax case, and also in conflict with the D.C. Circuit and this Court's *Montana* decision on basic questions of issue preclusion. Problems of issue preclusion occur constantly, and the stakes are often high, so that such an uncertainty should not be permitted to linger. It will generate unnecessary and wasteful litigation for all sides, and will interfere with the predictability necessary for parties to adjust their affairs, both in commercial matters involving taxes and generally.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A — DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING REHEARING FILED JUNE 4, 1996

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
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NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 4th day of June one thousand nine hundred and ninety-six.

Present:

Hon. Jon O. Newman

Hon. Richard J. Cardamone

Hon. José A. Cabranes

CIRCUIT JUDGES

Appendix A

DOCKET NO.: 95-6006

Leonard Greene and Joyce Greene,

Plaintiffs-Appellees,

v

United States of America,

Defendant-Appellant.

A petition for rehearing having been filed herein by Appellees: Lenoard and Joyce Greene.

Upon consideration thereof, it is

Ordered that said petition be and it hereby is **DENIED.**

GEORGE LANGE III, Clerk

s/ Beth J. Meador
Beth J. Meador,
Administrative Attorney

APPENDIX B — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED APRIL 2, 1996.

Leonard GREENE and Joyce Greene,

Plaintiffs-Appellees,

v.

UNITED STATES of America,

Defendant-Appellant.

No. 95-6006.

United States Court of Appeals,
Second Circuit.

Argued Oct. 12, 1995.

Decided April 2, 1996.

Taxpayers sought income tax refund for taxes assessed based upon their donation of regulated futures contracts to charity. The United States District Court for the Southern District of New York, Gerard L. Goettel, J., 864 F.Supp. 407, entered summary judgment for taxpayers, and government appealed. The Court of Appeals, Cardamone, Circuit Judge, held that regulated futures contracts donated to charity must be marked to market, and donating taxpayer must recognize any gain.

Affirmed in part, reversed in part, and remanded.

* * *

Appendix B

The United States appeals from the November 7, 1994 judgment of the United States District Court for the Southern District of New York (Goettel, J.), alleging that the district court improperly granted summary judgment in favor of taxpayers Leonard and Joyce Greene based upon its incorrect construction of 26 U.S.C. § 1256.

Robert W. Sadowski, Assistant United States Attorney, New York City (Mary Jo White, United States Attorney, Kay K. Gardiner, Assistant United States Attorney, Southern District of New York, New York City, of counsel), for Defendant-Appellant.

Sheldon H. Elsen, New York City (Melissa A. Cohen, Orans, Elsen & Lupert, New York City, Richard A. Sporn, Gerald & Lawrence Blumberg, New York City, of counsel), for Plaintiffs-Appellees.

Before NEWMAN, Chief Judge, CARDAMONE and CABRANES, Circuit Judges.

CARDAMONE, Circuit Judge:

This appeal in a tax case concerns those portions of the Internal Revenue Code that govern the tax treatment of regulated futures contracts. The personal income taxation system generally operates on a "cash basis," which means that it usually requires gains to be recognized — or losses to be claimed — when property is sold and money or property is received in exchange. *See* 26 U.S.C. § 1001 (1994). The cash basis accounting system applies to the sale of nearly all forms of property, including real estate and most securities. But for the taxation of regulated futures contracts, the subject of this appeal,

Appendix B

Congress requires the use of a different accounting regime. This different regime — known as "accrual" accounting — requires taxpayers annually to "mark" their futures contracts to "market," making adjustments to income for accrued economic gain or loss. *See* 26 U.S.C. § 1256 (1994). The "mark-to-market" system determines taxable income by making reference to changes in the actual market value of a taxpayer's futures contracts even when the taxpayer has not yet sold or exchanged the contracts or otherwise realized a gain or a loss. *See* Thomas L. Evans, *The Evolution of Federal Income Tax Accounting — A Growing Trend Towards Mark-to-Market?*, 67 Taxes 824, 825 (1989).

The plaintiffs in the instant case assert that the Internal Revenue Code (IRC) does not require that futures contracts that are donated to charity be marked to market. The district court agreed, finding an exception to the mark-to-market system when charitable donations are involved, and granted summary judgment for the taxpayers on November 7, 1994.

BACKGROUND

Because the relevant facts are not in dispute and have been fully discussed elsewhere, *see Greene v. United States (Greene I)*, 13 F.3d 577, 579-80 (2d Cir. 1994); *Greene v. United States (Greene II)*, 864 F.Supp. 407, 409-10 (S.D.N.Y. 1994), only those matters essential to the disposition of this appeal will be detailed.

Leonard and Joyce Greene (taxpayers) are a married couple. In the early 1970s, Mr. Greene founded the Institute for Socioeconomic Studies, Inc. (Institute), a non-profit, tax-exempt private foundation. Between 1974 and 1980 the Greenes donated futures contracts to the Institute in accordance with the terms of a private letter ruling from the Internal Revenue Service

(IRS). The ruling allowed the Greenes to donate futures contracts and claim a charitable deduction without violating the IRC or the rules of the New York Commodity Exchange. *Greene I*, 13 F.3d at 579.

In 1981, after the addition of § 1256 to the IRC, the Greenes changed their method of giving to the Institute. Section 1256 required taxpayers to characterize the gains or losses on futures contracts as 60 percent long-term and 40 percent short-term capital gains or losses, regardless of how long the contracts had been held. 26 U.S.C. § 1256(a). Since the rules governing charitable donations permitted a charitable deduction only for property that would have provided the taxpayer with a long-term capital gain, *see* 26 U.S.C. § 170(e)(1)(A) (1994), the Greenes simply arranged to give the long-term capital gain portion of their futures contracts to the Institute, retaining the short-term capital gain portion of the contract. This method of charitable giving was used by the Greenes from 1982 until 1987. *Greene I*, 13 F.3d at 579-80.

In 1990 the IRS sent taxpayers a Notice of Deficiency for 1982, seeking to include the total change in the fair market value of the futures contracts in their 1982 taxable income. It also disallowed the Greenes' deductions, asserted to be carryforwards, from 1983 through 1987 for the excess over the maximum charitable deduction allowed in 1982. After paying the deficiency, taxpayers filed a claim for refund with the IRS, which was disallowed. In May 1991 taxpayers filed suit in the United States District Court for the Southern District of New York. When the taxpayers moved for summary judgment, the district court ruled in their favor. *See Greene v. United States*, 806 F.Supp. 1165 (S.D.N.Y.1992).

Appendix B

The government appealed, making three arguments. First, it contended that the anticipatory assignment of income doctrine prevented the taxpayers from donating their futures contracts to the Institute without first paying income tax on the contracts. Second, it maintained that the step transaction doctrine should have been applied in order to treat the Greenes' donation as a sale followed by a gift of a portion of the sale proceeds. Third, it raised a new issue, alleging that 26 U.S.C. § 1256 required taxpayer recognition of the economic gain accrued with respect to a futures contract before it was transferred to the Institute. We rejected the government's first two arguments and "decline[d] the invitation to address" the third issue concerning § 1256. *Greene I*, 13 F.3d at 586. We held the Greenes were entitled to a refund for the 1982 tax year. *Id.*

Meanwhile, in March 1992, the IRS issued a Notice of Deficiency for the tax years 1983 through 1987. As before, the IRS ordered the Greenes to recognize and report as income an amount equal to the long-term capital gain portion of the donated futures contracts. The IRS also ordered payment of tax penalties under 26 U.S.C. §§ 6661, 6653, and 6621. And, as they had earlier, the Greenes paid the claimed deficiency and again filed for a refund. When this request was denied, the Greenes again brought suit in the Southern District of New York before Judge Goettel. *See Greene II*, 864 F.Supp. at 409-10.

The IRS advanced two arguments in opposition to the Greenes' suit. First, it denied the availability of a charitable deduction on the grounds that the Greenes had donated a partial interest in property. *See Greene II*, 864 F.Supp. at 410, 412-14, 26 U.S.C. § 170(f)(3) (1994) (generally precluding charitable deductions for donations of partial interests in property). Second, it declared that § 1256 required taxpayers to recognize

as taxable income the long-term capital gain portion of the futures contracts donated to the Institute. Both parties moved for summary judgment, and the district court ruled for the taxpayers, declining to adopt either of the government's theories. *See Greene II*, 864 F.Supp. 407.

This appeal followed. The government has abandoned the first ground — that the Greenes' donation was of a partial interest in property under § 170 — nor does it seek tax penalties pursuant to 26 U.S.C. §§ 6661, 6653, or 6621. Instead, the IRS raises only the second issue, that is, whether § 1256 requires recognition of a long-term capital gain when futures contracts are donated to charity. Hence, it is plain that whatever the outcome of this litigation, the Greenes will still be entitled to claim a charitable deduction. The question that we must answer is whether taxpayers must first recognize as income the long-term capital gains that accrued before the futures contracts were donated to the Institute.

DISCUSSION

We review the district court's grant of summary judgment *de novo*, and where, as here, no genuine issues of material fact are in dispute, we need only decide whether the law was correctly applied by the trial court. *See Siskind v. Sperry Retirement Program*, 47 F.3d 498, 503 (2d Cir.1996).

I Issue Preclusion

As a threshold matter the Greenes insist, as they did before the trial court, that the government is collaterally estopped from asserting any tax deficiency against them for the tax years 1983-1987. Because the facts in *Greene I* were substantially the same

as the facts before us now, the Greenes continue, the tax treatment of their charitable donation of futures contracts was conclusively determined in *Greene I*. Consequently, they conclude, the government's attempt to litigate the 1983-1987 deficiencies under a different theory than the one it principally relied on in adjudicating the 1982 tax deficiency is barred by the doctrine of collateral estoppel. The district court rejected this contention. Reasoning that the government's § 1256 claim was "analytically distinct from the issues in the previous litigation," it ruled that the claim could be advanced in the instant litigation. *Greene II*, 864 F.Supp. at 412. We agree.

When a court is asked to reexamine an issue once determined, the competing values of finality or attaining a more just or more uniform result come into play. The doctrine of collateral estoppel, in making a choice among these competing values, chose repose. The doctrine therefore embodies the notion that litigation, like all things, must have an end. This doctrine, called issue preclusion in the Restatement (Second) of Judgments § 27 (1980), provides that "once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979).

Issue preclusion is a doctrine of repose that permits a court to decide conclusively a question properly before it. It bars, among other things, repeated litigation of identical legal questions by the same parties. This important policy serves both litigants and the judiciary. *See Montana*, 440 U.S. at 153-54, 99 S.Ct. at 973-74. Yet, the collateral estoppel doctrine, as we have recognized, is narrowly applied in tax cases. *See ITT Corp. v. United States*, 963 F.2d 561, 564 (2d Cir.1992).

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The Supreme Court considered the doctrine in the context of tax litigation in *Montana*. It held that complete identity of issues need not exist to invoke collateral estoppel. Instead, a three-part test was established to guide courts in deciding whether a litigant is collaterally estopped from litigating a given issue. First, we must ascertain if "the issues presented by [the second] litigation are in substance the same as those resolved [in the first]." Second, we should examine "whether controlling facts or legal principles have changed significantly" since the initial decision. And, third, we look at the case carefully to consider if "other special circumstances warrant an exception to the normal rules of preclusion." *Montana*, 440 U.S. at 155, 99 S.Ct. at 975; *see also ITT Corp.*, 963 F.2d at 564.

Employing the Supreme Court's three-part test, we note initially with respect to step two that no controlling facts or legal principles have changed since the decision in *Greene I*. In addition, there are no special circumstances warranting an exception to preclusion. Hence, we turn to consider step one — whether *Greene I* presented substantially the same issue as that involved in the present case. While the government concededly raised the § 1256 question on appeal in *Greene I*, in the exercise of our discretion, we decided the case on other grounds, explaining:

> The government asks us to construe a 1981 statute. This task would require a thorough investigation of the legislative history of the statute, as well as the applicable case law. In its brief the government discusses the application of § 1256(c) in less than three pages, and at oral argument it did not mention the issue. No reason is offered by the

> government for the failure to raise it below, nor does it suggest that there will be any great injustice if we refuse to resolve it. Therefore, we decline the invitation to address this issue.

Greene I, 13 F.3d at 586.

In other words, we expressly refused to consider the government's § 1256 argument in *Greene I*. We have previously held that "if an appeal is taken and the appellate court affirms on one ground and disregards the other, there is not collateral estoppel as to the unreviewed ground." *Gelb v. Royal Globe Ins. Co.*, 798 F.2d 38, 45 (2d Cir.1986), *cert. denied*, 480 U.S. 948, 107 S.Ct. 1608, 94 L.Ed.2d 794 (1987). To intimate that a court's reasons for declining to discuss and resolve a given issue constitute an adjudication of that issue puts the doctrine of collateral estoppel at cross-purposes indeed. Therefore, our decision not to address or decide the § 1256 question in *Greene I* does not invoke the bar of collateral estoppel and consideration of that question may now properly proceed. *See Liona Corp. v. PCH Assocs. (In Re PCH Assocs.)*, 949 F.2d 585, 593 (2d Cir.1991) ("To hold that our intentional decision not to resolve this issue amounts to a final adjudication of the issue would be to misapply the settled law regarding issue preclusion.").

Further support for the view taken in the above decisional law is found in the Restatement (Second) of Judgments § 27 cmt. c (1980). The Restatement first acknowledges that determining the scope of an issue previously litigated is "[o]ne of the most difficult problems in the application" of issue preclusion. It then provides a series of questions to guide a court's inquiry when there is a lack of total identity between the matters presented, asking generally: whether there is a substantial overlap in the

evidence or argument between the two proceedings; whether the same rule of law as that relied on in the prior proceeding is invoked in the second proceeding; and whether the claims in the two proceedings are closely related. *Id.*

Here, while the evidence involved in the two cases is essentially the same, the government's new argument involves application of entirely different rules than those involved in the initial litigation. The earlier litigation dealt with the anticipatory assignment of income doctrine and the step transaction doctrine. There was no discussion of the merits of the § 1256 question. This litigation, then, poses wholly distinct questions than those involved and decided in *Greene I*.

Moreover, one of our reasons for not addressing the § 1256 issue in *Greene I* is that we found there would be no "great injustice" in declining to do so. Clearly, our prior decision would be unjust if the government's failure to raise the issue in the context of the Greenes' 1982 tax year prevented the government from raising the issue in analyzing future tax years. After all, "[e]ach [tax] year is the origin of a new liability and of a separate cause of action." *Commissioner v. Sunnen*, 333 U.S. 591, 598, 68 S.Ct. 715, 719, 92 L.Ed. 898 (1948). It is for this reason that the doctrine of *res judicata* or *claim* preclusion does not bar the government from now raising the § 1256 issue, forcing the taxpayers to rely instead solely on *issue* preclusion.

In sum, once an issue is squarely presented, litigated, and resolved, the *Montana* test bars subsequent litigation. Relying on the guides set forth in *Montana*, we agree with the district court's ruling that because there was no preclusion of the § 1256 issue it could properly reach the merits of that statutory question. We now do the same.

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II Interpretation of § 1256

Our reading of 26 U.S.C. § 1256 must be graded by general principles of statutory interpretation. While it cannot be disputed that construction of statutes requires "some imagination of the purposes which lie behind them," *Lehigh Valley Coal Co. v. Yensavage*, 218 F. 547, 553 (2d Cir.1914) (L.Hand, J.), *cert. denied*, 235 U.S. 706, 35 S.Ct. 282, 59 L.Ed. 434 (1915), the statutory language remains of paramount importance. This is because "[w]hen we find the terms of a statute unambiguous, judicial inquiry is complete, except in 'rare and exceptional circumstances.' " *Rubin v. United States*, 449 U.S. 424, 430, 101 S.Ct. 698, 701, 66 L.Ed.2d 633 (1981). Thus, in construing § 1256 we look first to its plain language.

A. *Statutory Language*

Section 1256 — titled "Section 1256 contracts marked to market" — provides, in relevant part:

> (a) **General Rule.** — For purposes of this subtitle —
>
> > (1) each section 1256 contract held by the taxpayer at the close of the taxable year shall be treated as sold for its fair market value on the last business day of such taxable year (and any gain or loss shall be taken into account for the taxable year),
> >
> > (2) proper adjustment shall be made in the amount of any gain or loss

subsequently realized for gain or loss taken into account by reason of paragraph (1),

(3) any gain or loss with respect to a section 1256 contract shall be treated as —

(A) short-term capital gain or loss, to the extent of 40 percent of such gain or loss, and

(B) long-term capital gain or loss, to the extent of 60 percent of such gain or loss

. . . . .

(b) **Section 1256 contract defined.** — For purposes of this section, the term "section 1256 contract" means —

(1) any regulated futures contract,

(2) any foreign currency contract,

(3) any nonequity option, and

(4) any dealer equity option.

(c) **Terminations, etc.** —

(1) **In general.** — The rules of

paragraphs (1), (2), and (3) of subsection (a) shall also apply to the termination (or transfer) during the taxable year of the taxpayer's obligation (or rights) with respect to a section 1256 contract by offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise.

. . . . .

(e) **Mark to market not to apply to hedging tractions. —**

(1) **Section not to apply. —** Subsection (a) shall not apply in the case of a hedging transaction.

26 U.S.C. § 1256 (1994).

Section 1256 instructs taxpayers on the correct method of income recognition when they sell or otherwise transfer regulated futures contracts. As the contracts donated by the taxpayers to the Institute are regulated futures contracts, they are governed by this provision. *See* § 1256(b). According to § 1256, a taxpayer's futures contracts are annually treated as if sold for fair market value on the final business day of the tax year. As every contract is "constructively sold" each year, a taxpayer must recognize accrued gains and losses annually by marking-to-market. *See* § 1256(a)(1). As noted earlier, this is a different accounting system than that used for the taxation of most other

property. For example, even while taxpayers know the annual increases or decreases in the value of common stock they hold on national exchanges, recognition of any capital gain or loss is delayed until the time of sale or exchange. The constructive recognition of accrued gain in § 1256 is an exception to the general rule set forth in the IRC. *Compare* 26 U.S.C. § 1256 *with* 26 U.S.C. § 1001.

Section 1256 also deems that 40 percent of the gain or loss is a short-term capital gain or loss and 60 percent a long-term capital gain or loss. *See* § 1256(a)(3). The statute takes into account the gain or loss constructively received during the previous year. This prevents double taxation or double deduction. In other words when a taxpayer's futures contract declines in value in Year 2 but increases in Year 3, the contract's value at the end of Year 2 serves as its basis when the taxpayer determines her liabilities in Year 3. In this fashion, a taxpayer claiming a deduction in Year 2 cannot deny liability in Year 3 by referring to her Year 1 basis. 26 U.S.C. § 1256(a)(2).

In § 1256(c)(1) this mark-to-market rule is applied to instances where taxpayers terminate or transfer their obligations or rights under a regulated futures contract. That is to say, the futures contract must not only be marked annually to market when a taxpayer retains the contract; it must also be marked-to-market when a taxpayer transfers the contract. Section 1256(c)(1) lists a variety of ways that a futures contract can be terminated or transferred: "[B] offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise." By their terms the mark-to-market rules appear to govern all terminations and transfers of futures contracts.

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Taxpayers assert that the language in § 1256(c) does not govern the charitable donation of futures contracts because they are terminations outside the context of a regulated market. They note that many of the words used in the statute, such as "offsetting" and "taking or making delivery," are terms of art in the commodity markets. This may well be true, but the statute also uses words of broader application that appear to refer to all terminations or transfers. There is no reason for excluding charitable donations from the definition of transfer. Indeed, the IRC's gift tax provisions categorize a gift as a "transfer" of property. *See* 26 U.S.C. § 2501(a)(1) (1994) (imposing tax on "transfer of property by gift"). When § 1256 lists several types of terminations and follows those with the words "or otherwise," the statute necessarily brings transfers of all kinds within its compass. The statute does not say "or other similar terminations," nor does it limit in any way the words "or otherwise." Consequently, the statute's plain language requires the taxpayers to mark their contracts to market and recognize any gain when they transfer a contract by donating it to the Institute.

The district court did not read the statute as just outlined, and instead effectively created an exception to the mark-to-market rules for charitable donations. We recognize that § 1256 does include as exception to the mark-to-market rules, but it does not involve the scenario in the case at hand. Rather, the statute explicitly exempts certain hedging transactions from the mark-to-market rules. 26 U.S.C. § 1256(e). Excepted hedging transactions are those a business commonly enters into not for the purpose of making a profit, but to reduce the risk inherent in some economic enterprises. *See* § 1256(e)(2). Because Congress considered this risk-reducing motivation to be unique, the statute does not require marking to market for specified hedging transactions.

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The ancient maxim *expressio unius est exclusio alterius* (mention of one impliedly excludes others) cautions us against engrafting an additional exception to what is an already complex tax code. *See Water Transp. Ass'n v. Interstate Commerce Comm'n*, 722 F.2d 1025, 1028-29 (2d Cir. 1983) (rejecting an argument that act of Congress that only conferred standing in a limited class of cases should be read to allow standing in other cases); *see also United States v. Smith*, 499 U.S. 160, 167, 111 S.Ct. 1180, 1185, 113 L.Ed.2d 134 (1991) ("Where Congress explicitly enumerates certain exceptions ... additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent."). Although the statute contemplates that a good reason exists not to apply the mark-to-market approach in hedging transactions, the charitable donation context does not fall within the rationale that brought about the statutory exception to the general mark-to-market rule, nor does the statute explicitly set forth an exception for donations to charity. Moreover, we should be especially reluctant to create an exception that would allow the capital gain to be excluded by the taxpayer. The Supreme Court has instructed that "an accession to wealth is not to be held excluded from income unless some provision of the Internal Revenue Code clearly so entails." *United States v. Burke*, 504 U.S. 229, 248, 112 S.Ct. 1867, 1878, 119 L.Ed.2d 34 (1992) (Souter, J.; concurring).

Taxpayers next point to the general rule for recognition of gain or loss in 26 U.S.C. § 1001 and argue that it governs this case. Section 1001 provides that realized gain is determined by reference to the money and property received in exchange for the disposition of property. Taxpayers claim that because they receive no money or property in exchange for the disposition of their futures contracts; their donations cannot result in taxable gain. Section 1001 is the relevant tax provision governing

recognition of gain or loss upon the transfer of most forms of property. Yet it does not control where § 1256 applies. When two statutes are in conflict, that statute which addresses the matter at issue in specific terms controls over a statute which addresses the issue in general terms, unless Congress has manifested a contrary aim. *See American Land Title Ass'n v. Clarke*, 968 F.2d 150, 157 (2d Cir.1992), *cert. denied*, 508 U.S. 971, 113 S.Ct. 2959, 125 L.Ed.2d 660 (1993). We therefore apply the recognition rules of § 1256, the statute that speaks directly to the transfer of regulated futures contracts, rather than the general language of § 1001. As a result, on the basis of the statute's language, no principled reason leads to a construction of § 1256 that would exempt donations to charity from the mark-to-market rule. The Greenes must therefore mark their futures contracts to market as of the dates the contracts are transferred to the Institute and recognize as income their accrued long-term capital gains.

B. *Legislative History*

Taxpayers further insist that Congress never intended the statute to apply to charitable donations. Although a statute's plain language is generally dispositive, it sometimes will yield when evidence of legislative history is so strong to the contrary that giving a literal reading to the statutory language will result in defeating Congress' purpose in enacting it. *See American Land Title Ass'n*, 968 F.2d at 155; *see also United States v. Ron Pair Enters.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989) (urging departure from plain meaning when it would "produce a result demonstrably at odds with the intentions of its drafters."). Thus, a short review of this section's legislative history is appropriate.

Section 1256 was amended as part of the Economic

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Recovery Tax Act of 1981, Pub.L. No. 97-34, § 503(a) 95 Stat. 172, 327 (1981) (codified as amended at 26 U.S.C. § 1256 (1994)). The legislative history demonstrates that the statute was enacted in order to harmonize tax treatment of commodity futures contracts with the economic realities of the marketplace. In so doing, Congress hoped to "end th[e] use of futures for tax-avoidance purposes, establish an accurate method of determining a taxpayer's futures income (or loss), and ease tax administration and paperwork for both Government officials and taxpayers." S.Rep. No. 144, 97th Cong., 1st Sess. 156 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 255 (Senate Report).

Before the enactment of § 1256, many taxpayers engaged in "commodity straddles," an abusive tax practice resulting from the nature of the commodities market. A "straddle" consists of establishing "matching" positions in two futures contracts — one contract to buy a commodity and one contract to sell the same commodity. When the market moved up or down as it inevitably did — one leg of the transaction showed a gain, the other a loss. The taxpayer liquidated the losing leg, thereby claiming a capital loss, and continued to hold that portion of his contract with an unrealized gain. Hence, the taxpayer suffered no economic loss and would, without economic risk, subsequently re-establish the straddle by purchasing another "matching" leg. During the following tax year, the taxpayer completely closed out his position; only then would he pay taxes on his capital gains. *Id.* at 254-55.

It was in this fashion that many taxpayers deferred capital gain taxes for one year and (in some cases) converted a short-term capital gain into a long-term capital gain. This arrangement was advantageous for taxpayers in two ways. First, where tax

rates are constant, tax deferral is equivalent to imposing the tax initially but not taxing subsequent profit from the continued investment of what is left after payment of the tax. In other words, tax deferral provides the same benefits as tax-free investment income. William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 Harv. L.Rev. 1113, 1126 (1974). Second, a long-term capital gain is often treated more advantageously than a short-term capital gain. *Cf.* 26 U.S.C. §§ 1212(b), 1222 (showing different classification of long-term and short-term capital gains). *See generally* H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-105-II-106 (1986), *reprinted in* 1986 U.S.C.C.A.N. 4075, 4193-94.

Beyond this, the legislative history reveals that Congress also wanted commodity traders to pay their taxes according to the same schedule used in commodity markets. In the commodity markets a trader must deposit additional funds into her account when her position decreases in value. Analogously, when her position increases in value, she may at once withdraw money from her account. The legislative history explains that "[b]ecause a taxpayer who trades futures contracts receives profits as a matter of right or must pay losses in cash daily, the committee believes it appropriate to measure the taxpayer's futures' income on the same basis for tax purposes." Senate Report at 256.

The legislative history shows that Congress intended § 1256 to have broad application, inasmuch as it explains that "*[u]nless specifically excepted*, all regulated futures contracts are subject to the mark-to-market rules." *Id.* at 257 (emphasis supplied). As the only specific exception included is the hedging exception, it would appear that § 1256 was directed at all other terminations or transfers, necessarily including the charitable donations at

issue. The district court therefore erred in concluding that the legislative history of § 1256 provided no support for the proposition that the mark-to-market rules were aimed at altering the availability of a charitable deduction when futures contracts are donated to charity. *See Greene II*, 864 F.Supp. at 416. Resort to legislative history is of no help to taxpayers; instead, it lends support to the construction derived from a reading of the statute's plain language.

C. *Tax Policy Considerations*

Finally, taxpayers assert that § 1256 was not directed at the sort of charitable gift they made, but at abusive tax dodges obtained through the use of straddles. They point to considerations of tax policy involved in the case at bar. Of course, Congress is responsible for determining tax policy. Nonetheless, it is worth noting that today's decision is consistent with the tax policy advanced by Congress in § 1256.

In 1981, Congress sought to adopt the IRS position that when an investor in commodity futures "ha[s] no reasonable expectation of deriving an economic profit from the transaction[,]" she should be denied a deduction. Senate Report at 254. While there is no suggestion that the Greenes were motivated by an impermissible desire to circumvent the IRC, the rule adopted by the district court would permit potential abuses akin to those prohibited by § 1256. For example, a taxpayer could establish a commodity straddle similar to the one discussed earlier. Assume that over time one leg gained $10,000 while the other lost $10,000. In real economic terms the trader has neither a gain nor a loss. Under the rule laid out by the district court the trader could then donate the long-term capital gain of $6,000 to charity and claim a $6,000 charitable deduction. *See* 26 U.S.C.

§ 170. The taxpayer could not claim a $4,000 charitable deduction by donating the short-term capital gain; tax law prohibits this. *See* 26 U.S.C. § 170(e)(1)(A). He would therefore elect to keep this $4,000 gain, which would be offset by a $4,000 short-term capital loss from the losing leg of the straddle. As the two cancel each other out, the taxpayer would pay no taxes on short-term gain. But when closing out his position by selling this contract, the taxpayer would also be entitled under the trial court's rule to claim a $6,000 long-term capital loss.

In short, a taxpayer could claim $12,000 in potential deductions — $6,000 as a charitable deduction and $6,000 for the long-term capital loss — while only incurring a real economic loss of $6,000. Such an outcome would subvert the tax policy behind the enactment of § 1256, which was to prevent investors from avoiding taxes by making futures investments which offered no chance of economic gain or loss. *See* Senate Report at 254-55. Our view of § 1256 would instead require a taxpayer to mark his $6,000 gain to market and recognize it as income before the contract is donated to charity. This way, the $6,000 loss and the $6,000 gain claimed as a result of market shifts would cancel each other out, leaving the taxpayer only with the $6,000 charitable deduction. Such a construction of the statute gives proper recognition to the economic reality of the transaction.

The district court correctly observed that "[t]axpayers are able to donate other types of property to charity without realizing capital gains as income." *Greene II*, 864 F.Supp. at 416. However, Congress has created a rule that treats futures contracts differently in a variety of contexts, one of which happens to be charitable donations. Should Congress wish to allow donors of futures contracts to engage in the practice

described above — to claim $12,000 in deductions when they have actually lost only $6,000 — it need only add a specific exception to § 1256, as it did in the hedging context. Without such a provision, we think it an inappropriate arrogation of legislative power for a court to amend the statute under the guise of judicial construction.

CONCLUSION

Accordingly, we remand this case to the district court with directions that it apply § 1256 in proceedings consistent with this opinion. Plaintiffs must mark their futures contracts to market at the time of termination or transfer — here, the time of donation to charity — and recognize any economic gain. As the Greenes have already paid the IRS in full for the tax years 1983-1987, their claim to a refund should be denied to the extent necessary to reflect the proper application of § 1256.

The judgment appealed from is affirmed in part, reversed in part, and remanded for further proceedings not inconsistent with this opinion.

APPENDIX C — OPINION OF THE UNITED STATES DISTRICT COURT SOUTHERN DISTRICT OF NEW YORK DATED OCTOBER 13, 1994

Leonard GREENE and Joyce Greene,

Plaintiffs,

v.

The UNITED STATES of America,

Defendant.

No. 94 Civ. 0617 (GLG).

United States District Court,
S.D. New York.

Oct. 13, 1994.

Taxpayers brought action for refund of approximately $2.8 million dollars in income taxes, interest, penalties assessed by the Internal Revenue Service (IRS), challenging recogniation of income and denial of charitable deductions for futures contracts donated to charitable institute. On cross-motions for summary judgment, the District Court, Goettel, J., held that: (1) taxpayers' conduct in donating 60% of commodities futures contracts that represented long-term capital gain, while retaining 40% of contracts representing short-term gain, did not give rise to donation of partial interest for which there could be no charitable deduction, and (2) market-to-market provisions of Internal Revenue Code did not require taxpayers to realize as income their capital gains from their donations of futures contracts.

Summary judgment for plaintiffs.

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* * *

Orans, Elsen & Lupert, New York City, Sheldon H. Elsen, of counsel Gerald & Lawrence Blumberg, New York City, Richard A. Sporn, of counsel, for plaintiffs.

Mary Jo White, U.S. Atty. for S.D. New York, New York City, Robert W. Sadowski, Asst. U.S. Atty., of counsel, for defendant.

OPINION

GOETTEL, District Judge:

Plaintiffs Leonard and Joyce Greene are suing the United States for a refund of a total of approximately $2.8 million in taxes, interest and penalties assessed by the Internal Revenue Service ("IRS") in connection with their tax returns for the years 1984 through 1987. The parties have cross-moved for summary judgment.

BACKGROUND

The pertinent facts of this case are not disputed. In the early 1970s, Leonard Greene founded the Institute for Socioeconomic Studies (the "Institute") and since then he has served as the Institute's president and as a director. The Institute is an exempt private operating foundation under 26 U.S.C. §§ 501(c)(3), 509(a) and 4942(j)(3).

In 1974, Greene received a private letter ruling ("the Ruling") from the IRS concerning the tax consequences of Greene's proposed plan to contribute futures contracts to the

Institute. Greene's apparent reason for seeking the Ruling, as indicated in the Ruling itself, was that the New York Commodity Exchange, Inc. would not recognize the transfer of Greene's interest in the contracts to a third party.

The IRS ruled that Greene would be entitled to a charitable contribution deduction for the fair market value of the contracts and would not realize any gain or loss of personal income, provided (1) that Greene transferred all of his equitable rights and interests in the contracts to the Institute, retaining only bare legal title, (2) that Greene executed an irrevocable power of attorney granting the Institute complete power to determine when and if the contracts were to be sold, and (3) that the amounts that Greene would have received from the sales would be paid directly to the Institute.

At various times in 1974 through 1978 and in 1980, the Greenes made charitable contributions to the Institute of commodities futures contracts according to the terms of the Ruling. The IRS audited the Greenes' returns for one or more of those years, and determined that no change was required in the returns.

The Economic Recovery Tax Act of 1981, Pub.L. No. 97-34, 95 Stat. 172 (1981) ("ERTA"), altered the tax landscape for donations of futures commodities. As amended, 26 U.S.C. § 1256 provided that gains or losses from any termination of a taxpayer's obligations or rights under such contracts would be treated as 60% long-term and 40% short-term capital gain or loss. This was a significant change, since § 170 of the Internal Revenue Code (the "Code") does not permit a charitable donation deduction for the value of donated property which would have been short-term gain to the taxpayer if the taxpayer had sold the property.

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Accordingly, when Greene donated futures commodities contracts to the Institute between 1982 and 1987, he donated only the portion of the futures contracts that was characterized under § 1256 as long-term gain, while retaining for himself the short-term gain portion of the contracts. Each of these donations was made pursuant to an agreement between Greene and the trustee for the Institute, Ralph Spector.

Pursuant to these agreements, the futures contracts Greene wished to donate to the Institute were transferred from Greene's personal accounts at Merrill Lynch Pierce Fenner & Smith ("Merrill Lynch") into a Special Account at Merrill Lynch which was controlled by a trustee of the Institute. Each of the futures contracts so transferred was sold shortly thereafter pursuant to standing instructions given by the trustee for the Institute to Merrill Lynch. The portion of the proceeds from such sales representing long-term capital gains was transferred to an Institute account at Merrill Lynch, and the portion of such proceeds representing short-term capital gains was transferred to Greene's account at Merrill Lynch.

For each tax year from 1982 through 1987, the Greenes recognized, reported and paid income tax on an amount equal to the *short*-term capital gain realized upon the sale of the selected futures contracts. The Greenes did not recognize and report as income an amount equal to the *long*-term capital gains realized upon the sale of the selected futures contracts.

On September 6, 1990 the Commissioner of the IRS issued a Notice of Deficiency to the Greenes for the tax year 1982. The IRS determined that the Greenes were required to recognize and report as income an amount equal to the long-term capital gain portion of the commodities futures contracts they had donated to

the Institute. The Greenes were allowed a charitable contribution deduction of cash in an amount equal to the long term capital gain realized on the sale of the selected futures contracts pursuant to 26 U.S.C. § 170. After paying the amount assessed by the IRS for the tax year 1982, the Greenes filed an action for refund of taxes, which action was assigned to this court.

In that case, the IRS based its position on two separate theories. *See Greene v. United States*, 806 F.Supp. 1165, 1168-73 (S.D.N.Y. 1992) ("*Greene I*"), *aff'd*, 13 F.3d 577 (2d Cir. 1994). First, the IRS argued that under the anticipatory assignment of income theory, Greene's donation of a portion of the unrealized gains in certain futures contracts was in substance an assignment of a portion of realized income. *Id.* at 1168. We rejected this claim, as did the Second Circuit, on the grounds that Greene did not have a fixed right to income at the time the transfer was made, nor did he have control over the sale of the donated futures contracts. 13 F3d at 581-83; 806 F.Supp. at 1168-72. We also rejected, as did the Second Circuit, the IRS's argument under the step transaction doctrine that Greene's donation of futures contracts and their subsequent sale by the Institute were merely separate steps in a single transaction. 13 F.3d at 583-85; 806 F.Supp. at 1172-73.

In March, 1992, the IRS issued to the Greenes a Notice of Deficiency for the tax years 1983 through 1987. As in the earlier Notice, the IRS determined that the Greenes were required to recognize and report as income an amount equal to the long-term capital gain portion of the donated commodities futures contracts. However, this time the IRS did not allow the Greenes any charitable contribution for the amounts donated, on the ground that the donations were non-deductible partial interests. Once again, the Greenes paid the IRS in full and then commenced this lawsuit seeking a refund.

Appendix C

ANALYSIS

To prevail on a motion for summary judgment, a party must demonstrate "that there is no genuine issue as to any material fact and that [it] is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). The instant dispute is entirely over the interpretation of the relevant law — no factual disputes are involved.

The government has conceded the assignment of income and step transaction theories for purposes of this case, but has set forth two other theories in support of the IRS's action with respect to the tax years 1983 through 1987. First, the government argues that the Greenes donated only a partial interest in the commodities futures contracts, and thus are not entitled to a charitable deduction pursuant to 26 U.S.C. § 170. Second, the government argues that under 26 U.S.C. § 1256, as amended by ERTA, the Greenes were required to recognize as income the capital gains in the futures contracts when they donated them to the Institute.

1. Collateral Estoppel

Before reaching the government's arguments, we consider the Greenes' contention that they are entitled to summary judgment based on the doctrine of collateral estoppel. The general theory of collateral estoppel has been summed up by the Supreme Court thus: "Under collateral estoppel, once an issue is actually and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979).

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In *Montana,* also a tax case, the Supreme Court set out a three-part test for determining whether collateral estoppel applies: "first, whether the issues presented by [the second] litigation are in substance the same as those resolved [in the first]; second, whether controlling facts or legal principles have changed significantly since the [first] judgment; and finally, whether other special circumstances warrant an exception to the normal rules of preclusion." *Id.* at 155, 99 S.Ct. at 975.

Plaintiffs argue that the issue of whether the Greenes donated only a partial interest in the futures contracts was decided in their favor by this court's opinion in *Greene I.* According to plaintiffs, one of the government's arguments in *Greene I* was that the Greenes had donated only a partial interest in the futures contracts, and thus should not be entitled to a charitable deduction. There is some support for this argument, since Section E, the last section of the government's *Greene I* brief, includes these words:

> Assuming *arguendo,* that Greene donated the long-term capital gain portion of the futures contracts, he contributed less than his entire interest in the futures contracts. Because he did not transfer this partial interest in trust, his entire claimed charitable contribution is not an allowable deduction. Therefore, the contribution as structured by Greene could not in any event result in an allowable charitable deduction under Section 170(a).

Memorandum of Law in Support of the Government's Motion for Summary Judgment at 27-28, *Greene I* (footnotes and citations omitted).

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Plaintiffs argue that even though our decision in *Greene I* made no mention of the partial interest issue, this court implicitly decided the issue in plaintiffs' favor by entering judgment for plaintiffs. This court could not have entered judgment for plaintiffs, plaintiffs argue, if we had agreed with the government's partial interest theory. *See Dennis v. Rhode Island Hosp. Trust Nat'l Bank*, 744 F.2d 893, 898-99 (1st Cir.1984) ("An issue may be 'actually' decided even if it is not explicitly decided, for it may have constituted, logically or practically, a necessary component of the decision reached."), *cited with approval in* Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction § 4420 n. 15.

The government denies having made the argument in *Greene I* that the Greenes had donated only a partial interest in the futures contracts. We believe the government has characterized the situation in *Greene I* accurately.

First, as the government points out, the IRS did not disallow the Greenes' charitable deduction for the 1982 tax year, which was the only tax year at issue in *Greene I*. One would not ordinarily expect the government's lawyers to go beyond the determinations made by the government's tax experts by pressing a legal argument that would disallow any charitable deduction.

Second, the government's brief before this court in *Greene I* consistently argued that the Greenes donated only income, not property. In two of the sections preceding Section E of the brief, the government argued that what appeared to be a gift of property was in fact a donation of income, or cash proceeds. Section E can be read as another argument of this type. Under this interpretation, the government's argument is as follows:

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1) if this were a gift of property, it would be a gift of a partial interest in property;

2) no charitable deduction is allowed for a gift of a partial interest in property;

3) since a charitable deduction was allowed, this must not have been a gift of property.

Unfortunately, the government did not include the last step of this argument in its brief. Understandably, plaintiffs interpreted this argument as an attempt to deny the Greenes a charitable deduction, and rebutted the argument in their reply brief. This court, however, read the argument as intended by the government.

Third, the very fact that absolutely no mention of the partial interest argument was made in this court's decision in *Greene I* confirms that we did not consider the government as having made such an argument. This court is not in the habit of issuing written opinions which omit any mention of an argument raised by the parties which is necessary to the judgment.

Fourth, the government made no mention of the partial interest issue in its appeal, which further suggests that it did not intend to raise this issue in *Greene I*.

Thus, we conclude that the issue of whether the Greenes donated only a partial interest in the futures contracts was not actually decided by our decision in *Greene I*. The government is not collaterally estopped from raising the issue in this action.

Plaintiffs also argue that the government is collaterally estopped from arguing that the marked-to-market provisions of the Code required the Greenes to recognize gain upon the donation of futures contracts to charity. According to plaintiffs, this is just another argument aimed at the issue that plaintiffs say was settled in *Greene I:* whether the Greenes had to recognize as income the long-term portion of the donated futures contracts. The government contends that it is raising a new issue, not merely a new argument.[1]

The question we must answer is "whether the issues presented by [the second] litigation are in substance the same as those resolved [in the first]." *Montana*, 440 U.S. at 155, 99 S.Ct. at 974. More specific guidance is provided by the Restatement (Second) of Judgments, which sets forth several relevant factors:

> Is there a substantial overlap between the evidence or argument to be advanced in the second proceeding and that advanced in the first? Does the new evidence or argument involve application of the same rule of law as that involved in the prior proceeding? . . . How closely related are the claims involved in the two proceedings?

Restatement, Second, Judgments § 27 (1982).

Guided by these principles, we find that the government's

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1. Although the government did not raise the marked-to-market provisions before this court in *Greene I*, it did argue the provisions on appeal. The Second Circuit, in its discretion, refused to consider the government's new contention. *Greene*, 13 F.3d at 586. The Court alternately referred to the government's contention as an issue and an argument. *Id.*

marked-to-market contentions represent a new issue which is not in substance the same as any of the issues resolved in *Greene I*. The previous litigation was concerned with whether in substance the Greenes' donations represented a sale of commodities contracts, followed by a donation. The focus of that litigation was whether the Greenes had control over the disposition of the donated futures contracts, and what rights the Greenes had in the contracts. The resolution of those issues turned on court-created doctrines.

The issue the government now raises is whether under the marked-to-market provisions of § 1256 the Greenes' donations were a termination of their rights in the contracts, requiring them to recognize the resulting gain. This is analytically distinct from the issues in the previous litigation, and will turn on statutory interpretation. Thus, the doctrine of collateral estoppel does not bar the government from raising the § 1256 issue before this court.

2. *Section 170(f)(3)*

The Internal Revenue Code does not allow charitable deductions for donations of partial interests in property. Twenty-Six U.S.C. § 170(f)(3) provides:

> **(A) In General.** — In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such

> interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.
>
> **(B) Exceptions.** — Subparagraph (A) shall not apply to —
>
> . . . . .
>
> **(ii)** a contribution of an undivided portion of the taxpayer's entire interest in property. . . .

According to the IRS' regulations, an undivided portion is "a fraction or percentage of each and every substantial interest or right owned by the donor in such property." 26 C.F.R. § 1.170A-7(b)(1)(i).[2]

The government argues that when the Greenes donated commodities futures contracts to the Institute but retained a right to the 40% of the contracts representing short-term gain, they donated only a partial interest in the contracts and thus should not get a charitable deduction for any portion of the donation. The Greenes argue that the statutory exception in § 170(f)(3)(B)(ii) applies to their contributions to the Institute, since they maintain that they contributed an undivided portion of the futures contracts.

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2. The Greenes do not rely on the language in § 170(f)(3)(A) concerning transfers in trust.

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It is not immediately clear from the language of § 170(f)(3) whether the division of a futures contract into long-term and short-term capital gains portions pursuant to § 1256 creates separate "interests." We must consider the legislative history to gain a fuller understanding of the provision. Section 170(f)(3) was added to the Code in 1969. The legislative history indicates that Congress was concerned that taxpayers not receive a double benefit from donating to a charity the use of property for a limited period of time. *See* H.R.Rep. No. 413, 91st Cong., 1st Sess, 1969 WL 5895 (Leg.Hist.) at 117-18 (1969) U.S.Code Cong. & Admin.News 1969, 1645. The best way to illustrate this is with an example. If a taxpayer received $100,000 in annual rental income, and gave $10,000 to charity, she would get the charitable deduction and be taxed on $90,000 of income. But if a taxpayer donated 10% of her rental space for a year, thus receiving $90,000 in rental income, and also received a charitable deduction, she would be taxed on only $80,000. Since the economic realities of these two situations are identical (in both cases the taxpayer has $90,000 of post-donation income and the charity has received a donation worth $10,000). § 170(f)(3) made sure that the tax consequences of these two situations were also identical.

Interestingly, the language of § 170(f)(3)(A) is broader than what would be needed to accomplish the goal discussed in the legislative history. Section 170(f)(3)(A) sweepingly disallows a charitable deduction for the donation of a partial interest in property, and defines the donation of the use of property as a particular application of this general rule. The language of the general rule seems to go beyond the purpose enunciated in the legislative history of not allowing taxpayers a double benefit. The general rule of § 170(f)(3)(A) seems to be that taxpayers cannot donate less than the full value of property while still

taking a deduction for the full value. Administrative rulings applying § 170(f)(3)(A) have emphasized this general rule. *See* Rev.Rul. 81-282, 1981-2 C.B. 78 (contribution of voting stock to charitable organization with donor retaining right to vote that stock represents contribution of partial interest); Rev.Rul. 76-143, 1976-1 C.B. 63 (irrevocable assignment to college of cash surrender value of life insurance with donor retaining right to designate beneficiary and to assign balance of policy subject to college's right to cash surrender value is contribution of partial interest).

We will first consider whether the Greenes' deduction should be disallowed under the prevention of double benefit approach suggested by the legislative history, and then we will consider whether the Greenes have retained substantial rights in the donated property, in violation of the general rule suggested by the language of § 170(f)(3)(A).

The government argues that the Greenes received a double benefit from their charitable deductions because they avoided income tax on the long-term capital gain in their appreciated futures contracts and also claimed a charitable contribution deduction equal to the amount of the long-term capital gain. This does appear to be a double benefit of the type described in the legislative history of § 170(f)(3), since the Greenes received a deduction for the value of property on which they had not been taxed, and which they did not have to report as income. Nonetheless, taxpayers may generally donate an appreciated long-term asset to charity and obtain a deduction for the full value of the asset, without reporting the appreciation in value as income. *See Greene*, 13 F.3d at 584 (It is a "well-established rule that a gift of appreciated property does not result in income to the donor.") (citing *Sheppard v. United States*, 361 F.2d 972, 977-78

(Ct.Cl. 1966) (per curiam) ("Congress, in an effort to encourage contributions to charitable organizations, has seen fit to permit a donor to deduct the full value of any gift of appreciated property without reporting as income from an exchange the appreciation in the value of the property which is thereby transferred.")).

It is clear from the legislative history of § 170(f)(3) that Congress intended the provision to disallow one kind of double benefit from charitable donations. However, the legislative history contains no indication that this aspect of § 170(f)(3) was intended to apply beyond the limited sphere of donations of the right to use property. A contrary interpretation of the legislative history would face the seemingly insurmountable task of explaining away the longstanding understanding that the Code *does* generally allow the kind of double benefit the Government is complaining about. In short, we find that the legislative history of § 170(f)(3) does not indicate that the Greenes should not be allowed a charitable deduction.

Next, we consider the government's argument from the general rule suggested by the language of § 170(f)(3). The Greenes argue that they transferred an undivided portion of the contracts to the Institute, namely the sixty percent representing long-term capital gains, without retaining any substantial rights in that portion of the contracts. The government counters that the tax aspects of the futures contracts represent important interests, and that a truly undivided portion of any futures contract would retain the 60-40 long-term gain versus short-term gain ratio of the whole contract.

In resolving this dispute, it is helpful to understand the nature of the 60-40 split in the characterization of capital gains

in donated futures contracts. As described above, the 60-40 split was added to the Code by ERTA in 1981. The legislative history concerning the split is sparse. One commentator has quite reasonably suggested that "the 40/60 allocation between short-term and long-term capital gain or loss was purely arbitrary and merely part of a compromise between the futures industry and the Treasury in determining the taxation of futures contracts." Mertens Law of Federal Income Taxation § 21A.04 n. 73 (1986).

Accordingly, we do not view the long-term and short-term capital gains portions as "substantial interest[s] or right[s] owned by the donor," 26 C.F.R. § 1.170A-7(b)(1)(i), that could not be divided in donating a portion of a futures contract. A statute apparently intended only to set a tax rate should not be extended to alter longstanding rules regarding deductions for charitable donations. The government has given us no evidence that the 60-40 split was intended to prevent taxpayers from engaging in the same types of charitable donations of futures contracts that were permissible before ERTA. Since it was legal before 1981 for the Greenes to choose to donate futures contracts representing long-term capital gains, without donating futures contracts representing short-term capital gains, it should be legal for the Greenes to donate only the long-term capital gains portion of futures contracts after 1981.

Moreover, the instant situation is distinguishable from the revenue rulings cited above where § 170(f)(3) was used to disallow charitable deductions, since the Greenes have not retained any interest in the portion of the futures contracts that they donated to the Institute.

In sum, we find that the Greenes donated an undivided portion of their entire interest in the futures contracts to the

Institute in donating only the portion of the contracts representing long-term capital gain.

3. Section 1256

The government's other main argument is that the marked-to-market provisions of 26 U.S.C. § 1256 required the Greenes to realize as income their capital gains from their donations of futures contracts. Section 1256, which was also part of ERTA, provides in pertinent part:

> **(a) General Rule.** — For purposes of this subtitle —
>
> **(1)** each section 1256 contract [including regulated futures contracts] held by the taxpayer at the close of the taxable year shall be treated as sold for its fair market value on the last business day of such taxable year (and any gain or loss shall be taken into account for the taxable year),
>
> **(2)** proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account by reason of paragraph (1),
>
> . . . . .
>
> **(c) Terminations, etc. —**
>
> **(1) In general.** — The rules of paragraphs (1), (2), and (3) of subsection (a) shall also

> apply to the termination (or transfer) during the taxable year of the taxpayer's obligation (or rights) with respect to a section 1256 contract by offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise.

The government contends that when the Greenes transferred their futures contracts to the Institute, and thus terminated their rights with regard to the long-term capital gain portion of those contracts, they were required by § 1256 to pay taxes on the difference between the fair market value of each futures contract on the date of the transfer and their basis in the futures contract.

Looking only at the language of § 1256, it is unclear whether the provision encompasses charitable donations. On the one hand, the language requiring marking-to-market upon "the termination (or transfer) . . . of the taxpayer's obligation (or rights) with respect to a section 1256 contract" is arguably broad enough to include contracts donated to a charity. On the other hand, the specific examples of terminations and transfers requiring marking-to-market — "by offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, [or] by lapse" — describe economic activity that seems fundamentally different from charitable giving. Since the language of § 1256 is ambiguous as to whether it applies to charitable donations, we must examine the legislative history to discern Congress' intent. *See Blum v. Stenson,* 465 U.S. 886, 896, 104 S.Ct. 1541, 1548, 79 L.Ed.2d 891 (1984).

As with ERTA's 60-40 characterization of capital gains for futures contracts, ERTA's "marked-to-market" rules represented

a novel approach to taxing futures contracts. Congress' intent, as evidenced by the legislative history quoted below, was to bring the taxation of futures contracts more in line with economic reality. The economic situation that motivated Congress to pass the "marked-to-market" rules has been described by one tax treatise as follows:

> All United States domestic futures trading exchanges employ a system known as "marked-to-market" accounting. Under "marked-to-market" accounting, each trader's equity or "cash" position in his futures contracts on an exchange is measured at the end of each trading day based on the net unrealized gain or loss on each open futures contract held by the taxpayer on such day (based on the exchange-posted settlement price for each contract on such day). . . .
>
> The real significance of marked-to-market accounting is that these changes to the taxpayer's equity position determine the taxpayer's margin requirements in the futures contract. If the price of a long position increases or the price of a short position decreases, the taxpayer's equity position under the marked-to-market system of accounting has increased and the taxpayer is allowed to withdraw funds from his margin account. On the other hand, if the price of a long position decreases and the price of a short position increases, the taxpayer's equity position has decreased and he may be

> required to put more funds into his capital account. Thus, the marked-to-market system of accounting treats paper profits and losses as economic profits and losses by requiring the futures trader to deposit cash or by allowing the trader to withdraw cash and adjust his cash position in the margin account.

Mertens Law of Federal Income Taxation § 21A.02 (1986).

In enacting § 1256, Congress took note of the fact that futures traders receive real economic gains and losses before they actually terminate their futures positions:

> The committee bill adopts a mark-to-market system for the taxation of commodity futures contracts. This rule applies the doctrine of constructive receipt to gains in a futures trading account at year-end. The application of this rule in present law means, for example, that taxpayers must include in their income any interest which has accrued during the year, even though they may not have withdrawn the interest from their savings accounts. Because a taxpayer who trades futures contracts receives profits as a matter of right or must pay losses in cash daily, the committee believes it appropriate to measure the taxpayer's futures' income on the same basis for tax purposes.

S.Rep. No. 144, 97th Cong., 1st Sess., 1981 WL 21359

(Leg.Hist.) at 306 (1981) U.S.Code Cong. & Admin.News 1981, 105, 266.

Section 1256 forces futures traders to take account of gains or losses at the end of each year, and upon any termination or transfer of the futures contracts, as defined in § 1256(c). The government argues that the integrity of the marked-to-market scheme requires that charitable donations of futures contracts be considered a termination or transfer that requires the donor to pay tax on unrealized gain. Boiled down, the government's position is that futures traders should not be able to avoid recognizing gain in futures contracts by donating them to charity. We do not see any other way in which the integrity of the marked-to-market scheme would be violated if charitable donations do not trigger the provisions of § 1256.[3]

We find the government's arguments unpersuasive. Taxpayers are able to donate other types of property to charity without realizing capital gains as income. Nothing in the legislative history of § 1256 indicates that the marked-to-market rules were intended to alter the charitable deduction for the donation of futures contracts.

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3. The government contends that when a futures trader withdraws funds from his margin account representing the unrealized gain in the futures contract that is not a taxable event. If such a trader subsequently gives the appreciated futures contracts to charity and is not taxed on the donation, the taxpayer would avoid income tax on the amounts withdrawn trom the margin account and could also claim the tull value of the contract as a charitable deduction. This the government contends would be an abuse of the marked-to-market rules It seems likely however that the value of the futures contract as a donation would be proportionately diminished if the trader had drawn against it in his margin account. Thus our position is not swayed by this argument.

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CONCLUSION

The Greenes' motion for summary judgment is granted, and the government's motion for summary judgment is denied. However, this disposition does not entirely resolve this action. On September 26, 1994, we granted a motion by plaintiffs, which was unopposed by the government, to amend the complaint to add a refund claim for the 1983 tax year. According to plaintiffs' affidavit, the 1983 claim involves many of the same legal issues as have been resolved by this ruling. As to those issues, the affidavit states that the parties intend to stipulate that the instant ruling is dispositive. However, the affidavit also indicates that the 1983 claim involves additional legal issues, and thus the instant action remains open.

SO ORDERED.

APPENDIX D — RELEVANT STATUTES

§ 1256. Section 1256 contracts marked to market

(a) **General rule.** — For purposes of this subtitle —

(1) each section 1256 contract held by the taxpayer at the close of the taxable year shall be treated as sold for its fair market value on the last business day of such taxable year (and any gain or loss shall be taken into account for the taxable year),

(2) proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account by reason of paragraph (1),

(3) any gain or loss with respect to a section 1256 contract shall be treated as —

(A) short-term capital gain or loss, to the extent of 40 percent of such gain or loss, and

(B) long-term capital gain or loss, to the extent of 60 percent of such gain or loss, and

(4) if all the offsetting positions making up any straddle consist of section 1256 contracts to which this section applies (and such straddle is not part of a larger straddle), sections 1092 and 263(g) shall not apply with respect to such straddle.

* * *

(c) Terminations, etc. —

(1) In general. — The rules of paragraphs (1), (2), and (3) of subsection (a) shall also apply to the termination (or transfer) during the taxable year of the taxpayer's obligation (or rights) with respect to a section 1256 contract by offsetting, by taking or making delivery, by exercise or being exercised, by assignment or being assigned, by lapse, or otherwise.

* * *

(3) Fair market value taken into account. — For purposes of this subsection, fair market value at the time of the termination (or transfer) shall be taken into account.

* * *

(e) Mark to market not to apply to hedging transactions. —

(1) Section not to apply. — Subsection (a) shall not apply in the case of a hedging transaction.

* * *

§ 1001. Determination of amount of and recognition of gain or loss

(a) Computation of gain or loss — The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section

1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount realized. — The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized —

> **(1)** there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser, and
>
> **(2)** there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) Recognition of gain or loss. — Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.

* * *

Supreme Court, U.S.
FILED
NOV 4 1996
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No. 96-345

In the Supreme Court of the United States

OCTOBER TERM, 1996

LEONARD GREENE AND JOYCE GREENE, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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15 pp

QUESTION PRESENTED

Whether, when the government unsuccessfully contended in a prior suit with the taxpayer that a particular transaction was subject to tax, the doctrine of collateral estoppel bars the government thereafter from asserting in a subsequent suit involving later tax years of the taxpayer that a similar transaction is subject to tax under a legal theory that was not presented and not addressed in the first suit.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. 3a-24a) is reported at 79 F.3d 1348. The opinion of the district court (Pet. App. 25a-46a) is reported at 864 F. Supp. 407.

JURISDICTION

The judgment of the court of appeals was entered on April 2, 1996. A petition for rehearing was denied on June 4, 1996. Pet. App. 1a-2a. The petition for a writ of certiorari was filed on August 30, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

STATEMENT

1. During 1974 and for several years thereafter, petitioners Leonard and Joyce Greene made contributions of futures contracts owned by them to the Institute for Socioeconomic Studies, a tax-exempt private foundation that Mr. Greene had founded. The Internal Revenue Service issued a private ruling which determined that petitioners were entitled to a charitable contribution deduction for the fair market value of the donated contracts and that petitioners would not realize any gain or loss on the Institute's subsequent sale of the contracts (Pet. App. 6a).

The availability of this favorable tax treatment for the donation of futures contracts was altered by the 1981 amendment to the Internal Revenue Code, which added Section 1256(a). Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 503(a), 95 Stat. 327. As amended, Section 1256 provided (i) that all commodities futures contracts acquired, and positions established after, June 23, 1981, were to be marked to market at year end and (ii) that gains (or losses) in such contracts or positions, regardless of how long they had been held, would be characterized as 60 percent long-term and 40 percent short-term capital gains (or losses). 26 U.S.C. 1256(a). In addition, Section 170(e)(1) of the Code (as in effect after 1969) required the allowable deduction for charitable contributions to be reduced by the amount of short-term capital gain that would have been realized by the donor if he had sold the property on the date that the donation was made. 26 U.S.C. 170(e)(1) (1970 ed.).

2. In an attempt to avoid the combined effect of these provisions for gifts to the Institute in the years 1982-1987, petitioners purported to convey only the

long-term capital gains interest in the futures contracts, purporting to retain the short-term capital gains interest for themselves. On their federal tax returns for those years, petitioners claimed charitable contribution deductions for the 60 percent long-term capital gains portion of the contracts and included in their gross income the 40 percent short-term capital gains portion of the contracts.

Upon audits of those returns, the Internal Revenue Service determined that petitioners were required to include in their gross income the long-term capital gains portion of the donated contracts as well as the short-term capital gains portion. That determination was reflected in two notices of deficiency sent to petitioners. The first notice was sent in 1990 and pertained only to the 1982 tax year. The second notice was sent in 1992 and covered the 1983-1987 tax years (Pet. App. 6a-7a).

3. Petitioners paid the 1982 deficiency and brought a refund suit in federal district court. The government maintained that petitioners' purported contribution of the long-term capital gains portion of the futures contracts was an anticipatory assignment of income that was ineffective to permit them to avoid the incidence of tax on the donated portion of the sale proceeds (Pet. App. 7a). See *Lucas* v. *Earl*, 281 U.S. 111 (1930).

The district court disagreed. It held that petitioners had made a contribution of a discrete property interest in the futures contract and not merely a contribution of a portion of the proceeds to be realized by the Institute upon the subsequent sale of the contracts. *Greene* v. *United States*, 806 F. Supp. 1165 (S.D.N.Y. 1992). On appeal, the Second Circuit affirmed. 13 F.3d 577 (1994). The court of appeals

concluded that the critical fact was that taxpayers had transferred complete control over the contracts to the Institute, which had sole discretion to determine when and if to sell the contracts. *Id.* at 581-582.

As an alternative to the contention that petitioners had made an anticipatory assignment of income, the government contended in its brief on appeal that, if petitioners had made a complete transfer of a property interest in the contracts (as the district court had held), then petitioners were required by Section 1256(c)(1) of the Internal Revenue Code to recognize all of the gain that would have been realized if the contracts had been sold on the dates that they were transferred to the Institute. The court of appeals refused to consider the government's argument under Section 1256(c)(1), however, because that issue had not been raised or addressed in the district court. 13 F.3d at 585-586.

4. After paying the asserted deficiencies for the 1983-1987 tax years, petitioners then commenced this (second) refund suit in district court. The government argued in district court that petitioners' charitable contributions of their interests in the futures contracts to the Institute effected a termination of all their rights with respect to the contracts within the meaning of Section 1256(c)(1), and that petitioners were therefore required under Section 1256(a)(1) to include in their gross income for the years in issue all of the gain inherent in those contracts on the dates of the contributions. Petitioners disagreed with that contention and further argued that the decision in the first refund suit—involving the 1982 tax year—collaterally estopped the government from raising this new issue (Pet. App. 8a-9a, 30a-35a).

The district court rejected the suggestion that collateral estoppel bars the government from raising a new issue in a new tax year. The court noted that this refund suit involves different tax years than the first suit and is therefore a separate and distinct cause of action. The court concluded that, in the second refund suit, the doctrine of collateral estoppel precludes the government only from relitigating issues that had actually been litigated and decided in the first suit. Because the question whether transactions of this type were subject to Section 1256 had not been litigated or addressed in the first suit, the court concluded that the government was not precluded from litigating that issue now (Pet. App. 34a-35a). The court ultimately concluded, however, that petitioners were correct on the merits of the Section 1256 issue and therefore entered judgment in petitioners' favor (Pet. App. 41a-46a).

5. The court of appeals agreed with the district court that the decision in the first suit did not collaterally estop the government from pursuing its Section 1256 claim in this case. The court of appeals noted that the government had attempted to raise Section 1256 as an alternative basis for reversal of the district court's judgment on appeal in the first refund case but that the court of appeals, in the exercise of its discretion, had declined to consider that issue because it had not been raised in the district court. The court noted that, in these circumstances, it could not be said that the government was attempting to relitigate a matter that already had been decided against it in the first case (Pet. App. 8a-12a). The court explained that (*id.* at 12a):

> while the evidence involved in the two cases is essentially the same, the government's new argument involves application of entirely different rules than those involved in the initial litigation. The earlier litigation dealt with the anticipatory assignment of income doctrine and the step transaction doctrine. There was no discussion of the merits of the § 1256 question. This litigation, then, poses wholly distinct questions than those involved and decided in *Greene I*.

The court then proceeded to hold for the government on the merits of the Section 1256 issue (Pet. App. 13a-24a).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.[1]

1. a. This Court held almost 50 years ago that "[e]ach [tax] year is the origin of a new liability and of a separate cause of action." *Commissioner* v. *Sunnen*, 333 U.S. 591, 598 (1948). The doctrine of *res judicata*—or claim preclusion—therefore does not prevent successive tax litigation between the government and the same taxpayer when each suit involves different tax years. *Ibid.* See also *Montana* v. *United States*, 440 U.S. 147 (1979). By contrast, the doctrine of collateral estoppel—or issue preclusion—*may* have application in a subsequent suit between the government and the same taxpayer. But collat-

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[1] Petitioners do not seek review of the portion of the decision of the court of appeals that upholds the government's application of Section 1256 on the merits.

eral estoppel serves only to bar relitigation in a subsequent suit of those issues that were actually litigated and decided in a prior suit between the same parties. As this Court stated in *Montana* v. *United States*, 440 U.S. at 153 (emphasis added), "[u]nder collateral estoppel, once an issue is *actually* and necessarily determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation." See also *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 326 n.5 (1979).

b. Because the first refund suit involved only petitioners' 1982 tax year, it obviously does not bar (as *res judicata*) the present litigation, which seeks a refund of taxes paid in their 1983-1987 tax years. Each tax year creates a separate cause of action.

The doctrine of collateral estoppel is also not applicable in this case because the issues raised and addressed in the first refund case are not raised or addressed in this case. The first case decided that petitioners' contribution in 1982 of certain future contracts did not involve an anticipatory assignment of income but instead effected a completed transfer of a discrete property interest in the contracts. 13 F.3d at 581-582. The present case involves the tax consequences of petitioners' contribution of *different* futures contracts in *different* years (1983-1987) and the government did not seek to relitigate in this case the anticipatory assignment of income theory previously decided against it. Instead, in the present case, the government raised a different issue, contending that petitioners were required to recognize gain on their transfers of futures contracts in the years 1983-1987 under Section 1256 of the Code.

Indeed, in the present case, the government fully accepted the holding in the first case that petitioners' method of contribution effected a completed transfer of a discrete property interest in the futures contracts. The government maintained that, under Section 1256(a) and (c), the necessary consequence of such a completed transfer was that petitioners must recognize the gain that they would have realized if they had sold the contracts for their market value on the date that the contracts were transferred—an issue that was not considered by either court in the prior litigation.

As both courts below correctly ruled, because the government's claim under Section 1256 was not actually litigated and decided in the prior refund case, the government is not collaterally estopped from raising that issue in this case.[2]

c. Petitioners contend (Pet. 7-12) that the doctrine of collateral estoppel bars the government from relying on Section 1256 to require the recognition of gain on their contributions of future contracts in the 1983-1987 tax years because the government *could* have raised that issue in the prior litigation involving similar contributions in their 1982 tax year. The doctrine of collateral estoppel, however, unlike *res judicata*, bars only the relitigation of matters *actually* litigated and decided in a prior suit between the

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[2] The government belatedly attempted to raise the Section 1256 issue on appeal in the first case, but the court of appeals declined to consider it because it had not been raised in the district court. 13 F.3d at 585-586. In the present case, the court of appeals correctly noted that the government is not estopped from raising an issue that had not been actually litigated and resolved in the prior litigation (Pet. App. 10a-12a).

same parties involving a different cause of action. *Montana* v. *United States*, 440 U.S. at 153. It does not bar a party from litigating, in a subsequent action, an issue that could have been, but was not, actually litigated in a prior suit between the same parties. *Ibid.* This principle has particular force in the present context, for this case involves not only different tax years than the first case but also involves entirely new and distinct transactions.

Contrary to petitioners' claim (Pet. 12), this Court's decision in *Montana* v. *United States* does not support a more expansive concept of collateral estoppel. The Court held in that case that a suit between a government contractor and the State of Montana concerning the constitutionality of the State's gross receipts tax collaterally estopped the government from thereafter challenging the constitutionality of that tax in a second suit because (i) the government had exercised control over the prior suit and (ii) the government was seeking to raise the same issues that had been actually litigated and decided against it in the prior suit. Nothing in that decision supports petitioners' claim that collateral estoppel bars the government from relying on a new and distinct legal issue in a subsequent case against the same taxpayer when the government might have, but did not, succeed in raising that issue in the prior suit involving a different tax year and different transactions. As this Court held in *Montana* v. *United States*, collateral estoppel applies only to matters "actually and necessarily determined" in a prior suit between the same parties. 440 U.S. at 153.

2. Petitioners further err in contending (Pet. 7-10) that the decision in this case conflicts with *Kamilche Co.* v. *United States*, 53 F.3d 1059 (1995), modified, 75

F.3d 1391 (9th Cir. 1996), and *Yamaha Corp.* v. *United States*, 961 F.2d 245 (D.C. Cir. 1992), cert. denied, 506 U.S. 1078 (1993).

a. *Kamilche Co.* involved a taxpayer's entitlement to a charitable contribution deduction for certain real property the taxpayer claimed to have donated to the State of California. The Commissioner contended that the State of California had acquired title to the property by adverse possession prior to the time of the taxpayer's purported donation and that the taxpayer therefore was not entitled to a charitable contribution deduction with respect to the property. The Ninth Circuit held, however, that the taxpayer's ownership of the property had been conclusively determined in a prior condemnation proceeding instituted by the United States against the taxpayer that concerned a small portion of the tract needed for a federal highway bypass. In that prior case, the taxpayer had received judgment against the United States for $300,000. The court held, in the subsequent case involving the charitable donation of the remaining portion of that land, that the government was collaterally estopped from contesting the taxpayer's ownership of the property. The court held that it did not matter that the government had not raised an adverse possession argument in the prior proceeding because the issue of the taxpayer's ownership of the property had been actually litigated and necessarily decided in the earlier suit. 53 F.3d at 1062-1063.

The present case differs markedly from *Kamilche Co.* In the 1982 tax year litigation, the court held that petitioners made completed transfers in 1982 of discrete property interests in their futures contracts and had not simply made anticipatory assignments of the income to be realized upon the subsequent sale of

the contracts. In the present suit involving the 1983-1987 tax years, the government did not collaterally attack the decision that petitioners had made completed transfers of property. Instead, the government affirmatively relied on that earlier holding as the basis for the new claim that, because petitioners *had* transferred their interests in the futures contracts, they were required under Section 1256 to recognize the gain inherent in those contracts. Unlike the question of title in *Kamilche Co.*, the question of liability under Section 1256 had not actually been litigated and decided in the prior suit.

b. The decision of the District of Columbia Circuit in *Yamaha Corp.* is also not in conflict with the decision in this case. In *Yamaha Corp.*, the plaintiff brought suit against the United States, contending that certain regulations of the United States Customs Service were invalid under the Tariff Act of 1930 and under the Trademark Act of 1946. The court of appeals held that the plaintiff was collaterally estopped from litigating the validity of those regulations because the plaintiff had unsucessfully litigated that same issue in a prior suit. Although the plaintiff attempted to advance new arguments in support of its claim that the regulations were invalid, the court held that the plaintiff was precluded from contesting the same regulations on the basis of arguments that were advanced by to it in the prior proceeding. 961 F.2d at 254-258.

Unlike the situations in *Kamilche Co.* and *Yamaha Corp.*, the government has not sought in this case to relitigate a cause of action or an issue that was previously adjudicated in a prior suit. Instead, as we have explained above, the government relied on the decision in the prior suit as the underlying basis for

its claim in this case that petitioners were required under Section 1256 to recognize gain on the futures contracts they donated in the years 1983-1987. Nothing in *Kamilche Co.* or *Yamaha Corp.* suggests that the doctrine of collateral estoppel precludes a losing party from accepting the decision in the prior case and raising a new claim for relief in a later suit involving a different transaction and a different cause of action.[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[3] None of the additional cases cited by petitioners (Pet. 11 n.3) conflicts with the decision in this case.

Supreme Court, U.S.
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No. 96-345

In The

Supreme Court of the United States

October Term, 1995

LEONARD GREENE and JOYCE GREENE,

Petitioners,

vs.

THE UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

Petitioner submits this short reply brief because the Government's brief in opposition would eliminate the conflict between the Circuits by assuming it away.

In the conflicting Ninth Circuit case, *Kamilche Co. v. United States*, 53 F.3d 1059 (1995), *modified*, 75 F.3d 1391 (9th Cir. 1996), resolution of the issue involved in earlier litigation, that a taxpayer owned certain property, was held to preclude further litigation affecting the question of ownership even though the second case involved entirely different rules, drawn from the doctrine of adverse possession, that were available in the first case but not invoked.

The Second Circuit's holding in this case is to the contrary. Here the earlier litigation determined that capital gain need not be recognized when the long-term portions of appreciated commodity futures are donated to a recognized charity. Yet the Second Circuit permitted further litigation that affected the question of such capital gain recognition, and indeed changed the result, in a second case where different rules were invoked. Those different rules, drawn from I.R.C. § 1256, had been available in the first case but were not argued (or were not argued sufficiently to be considered).

The Second Circuit permitted the second litigation about recognition of gain, even though the court found that "the evidence involved in the two cases [was] essentially the same", because the "new argument involves application of entirely different rules than those involved in the initial litigation." *Greene v. United States*, 79 F.3d 1348, 1353 (2d Cir. 1996) ("Greene II"). Thus the two Circuits applied different, indeed opposite standards, and reached different conclusions about issue preclusion.

The Government argues here that the first *Greene* case only decided "that petitioners had made completed transfers of property." (Brief in Opposition, p. 12). This is incorrect. What *Greene I* decided was that capital gain did not have to be recognized when the long-term portions of appreciated commodity futures were donated to the charity. If one were to apply the Government's *Greene II* reading to *Kamilche,* it would result in issue preclusion only of subsidiary findings and holdings, but not of the question of ownership, and permit litigation of adverse possession in the second case. The Ninth Circuit did not so hold and thus differed from the Second Circuit, which took a narrow definition of the issue which had been determined, as the Government would. What is important here, however, is not who was right in defining the scope of the issue which had been determined — a difficult task — but rather recognition of the conflict between the Circuits.

The same problem appears in the Government's treatment of the conflicting District of Columbia decision, *Yamaha Corp. v. United States,* 961 F.2d 245 (D.C. Cir. 1992), *cert. denied,* 506 U.S. 1078 (1993). The brief in opposition reads that case as holding "[a]lthough the plaintiff attempted to advance new arguments . . . [it] was precluded from contesting the same regulations on the basis of arguments that were advanced by to it [sic] in the prior proceedings." (Brief in Opposition, p. 11). An apparent typo blurs the brief's meaning, but our best guess is that the Government is doing the same thing for *Yamaha* as for *Kamilche,* making semantic distinctions that obscure the real conflict in legal doctrine between the Circuits.

The question for this Court is whether to determine issue preclusion by applying the "different rules" analysis of the Second Circuit or the "different rules" analysis of the Ninth and D.C. Circuits. The Solicitor General commendably makes no effort to deny the great importance of resolving such a

question if this Court finds that the Circuits are in conflict. We submit that the conflict is real and we respectfully request this Court resolve it.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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